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MICHIGAN'S EXPERIENCE WITH PUBLIC ACT 198

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Michigan provided few financial incentives to attract and hold business until 1974, when several job development programs were enacted. The most important of these was Public Act 198, the Plant Rehabilitation and Industrial Development Districts Law. This legislation gives communities the authority to grant property tax exemptions to new manufacturing firms and to firms that rehabilitate obsolete facilities. For the former, the exemption amounts to 50 percent of the normal property tax liability incurred each year for up to 12 years. For the latter, the obsolete property's assessment is frozen for up to 12 years, effectively exempting the firm from property taxes on the improvements. Certain restrictions are placed on the use of the act for projects that transfer employment within the state or do little to create or retain jobs. However, these restrictions are largely ineffective.

Public Act 198 was a product of the difficult economic times of the mid-1970s, a period during which the Michigan unemployment rate reached 14 percent. Although the state's unemployment problems were largely cyclical, it was viewed by many as having an inhospitable business climate, in part because of high taxes. Business and government leaders in Michigan were convinced the state could not compete for jobs without financial incentive programs for business. The result was Public Act 198 and several other job development programs.

In the first few years that Public Act 198 has been in effect (1974–1978), 1,084 industrial projects have received tax benefits under its provisions. These projects were expected to be completed with a total capital investment of more than $4.2 billion. These investments have resulted in the creation of 62,000 jobs and the retention of 71,000 (see Table 1). How much credit the act should be given for these jobs has been much debated.

TABLE 1
Summary of Approved Projects under Public Act 198 of 1974 (by year of approval)

Year	*Number of applications*	*Expected jobs retained*	*Expected jobs created*	*Exempt project cost*
1974	4	5,300	340	$ 64,162,943
1975	117	14,049	9,795	410,346,793
1976	191	10,272	10,777	436,678,889
1977	305	17,740	18,799	1,241,419,566
1978	466	23,433	22,436	2,083,115,932
Total	1,084	70,794	62,147	$4,235,724,123

SOURCE: Office of Economic Development, Michigan Department of Commerce.

Supporters of the act argue that it offers several benefits.

1. It reduces a firm's tax bill, making it more profitable to expand now rather than later and to locate in one place rather than another. This becomes of paramount importance when cost differentials between competing sites are small.
2. It not only grants a tax exemption but also demonstrates the state's commitment to economic growth and the community's desire to cooperate with industry.
3. In practice, the best that communities in Michigan can do to attract industry is to be competitive with communities in other states. The act accomplishes this and allows exemption decisions to be made at the local level.

Opponents claim several disadvantages.

1. The act offers an unnecessary tax exemption resulting in lost public revenue because industrial expansion would take place anyway. In deciding between different states, other cost and locational factors far outweigh the influence of tax exemptions.
2. The act fosters unnecessary competition among neighboring communities.
3. Tax abatements are likely to be most useful to small companies, yet the benefits go mainly to larger firms.

The long history of state and local tax incentives has provided ample opportunity for close observation and study of the effectiveness of such programs. The weight of evidence indicates that tax and financial incentives do not affect industrial location decisions. However, there are inherent problems in the methodology used for evaluation, and it is unlikely that anyone will be able to provide conclusive evidence in the near future. Tax incentives continue to proliferate, however, and many business and governmental decision makers continue to believe incentives do make a difference or, at least, are needed to counteract incentives provided by other states.

Michigan has undertaken several studies to determine the effect of Public Act 198 on local communities and its effectiveness in influencing business location decisions. None has provided a definitive answer, but the results do shed some light on the program.

A RECENT SURVEY

Earlier this year, the Michigan Department of Commerce surveyed the industrial firms participating in the Public Act 198 program to determine how incentives such as tax abatements influence plans to expand or build a plant. A questionnaire was mailed to 469 companies that had received tax benefits under the act for at least one year. By the closing date, 251 questionnaires had been returned — a response rate of 54 percent.

The first major finding was that, compared with all manufacturing firms in Michigan, very small companies are underrepresented among users of the act (see Table 2). Firms employing fewer than 100 workers constitute 89.8 percent of all manufacturing firms in Michigan, but only 53.5 percent of the users of the act. However, the number of small companies participating in the program has increased in the past two or three years. (Very small companies were not a target of the act.)

A second major finding was that more than 80 percent of the users of the act have been in business in Michigan more than 10 years; more than 50 percent for more than 25 years. This, of course, indicates the act has been used primarily to assist expansion. More important, it suggests the program is benefiting the mature, stable businesses that are unlikely to relocate or expand in another state. In other words, most of these firms probably would have expanded in Michigan without a tax incentive. However, the survey also indicated that newer businesses are making increasingly greater use of Public Act 198. In 1975, 9 percent of the users surveyed had been in business less than 10 years; in 1977, 22 percent fell in this category.

A third interesting finding was that about 60 percent of the users of the act had not considered another plant site, either in Michigan or in another state. This would seem to indicate the tax incentive did not influence their investment decisions. However, about 39 percent of the firms had considered a site in another state. It is possible that many of these would have relocated or expanded outside Michigan without the act.

A fourth finding is illustrated in Table 3, which indicates that the most critical business location issue is the cost of workers' compensation. Companies reported this as the most likely reason to cancel their plans to expand or build in Michigan. The survey also revealed that although about 15 percent of Public Act 198 users would build in Michigan without an incentive, about 20 percent would cancel their plans. More than twice as many jobs were created by firms that would cancel their expansion

TABLE 2
Public Act 198 Users, by Size of Firm

Number of employees	*Respondents*		*Total manufacturing businesses in Michigan (percentage)*
	Number replying	*Percentage participating*	
1– 19	33	13.4	62.7
20– 99	99	40.1	27.1
100–249	63	25.5	5.9
250–999	40	16.2	3.3
1,000 and up[a]	12	4.9	1.0
Total	247	100.0	100.0

SOURCE: Office of Economic Development and Michigan Employment Security Commission.
[a]Four firms did not provide data.

TABLE 3
Effect of Incentives and Other Factors on the Expansion Plans of Public Act 198 Users

	We would build on schedule anyway	*We would reconsider building*	*We would cancel our plans*
If the Single Business Tax were replaced by the former system of corporate income taxes, franchise fees, inventory property taxes, and so forth	46.6%	41.0%	4.0%
If a state-sponsored employment training program were not available	75.7	13.5	0.4
If special property tax exemptions for building (or rehabilitating) a plant were not offered	15.5	56.2	20.3
If your unemployment insurance costs continue to rise as they have in the past	9.2	45.4	37.8
If your workers' compensation costs continue to rise without legislative reform	6.0	43.0	43.8

SOURCE: Office of Economic Development, Michigan Department of Commerce.

without the act than by those that would build anyway. Expansion also may be affected by the availability of tax exemptions. Of all the firms considering expansion in the next year, 26 percent stated they would cancel their plans without the act, and more than 80 percent of the firms that would cancel if no tax exemptions were offered were thinking of expanding during the next five years. Also of interest is the finding that fewer than one-third of the firms indicating they would build without a property tax exemption had considered building in another state, whereas more than half of those that stated they would cancel their plans without a tax incentive had considered locating in another state.

The survey also found that the act was the principal incentive program that encouraged firms to locate or expand in Michigan (see Table 4). This result could have been predicted given the wording of the question. All that is measured is the importance of the act compared with other business incentives. Given that it is by far the major tax incentive offered in Michigan, its advantage over the other incentives is not surprising.

Finally, the survey found that reforms in the workers' compensation and unemployment insurance systems were top priorities, whereas retention of Public Act 198 was considered much less important by business. Only 11 percent of the firms mentioned tax incentives, a surprisingly low figure (see Table 5).

The Department of Commerce concluded from the survey that

> the P.A. 198 tax exemption program in Michigan has been one of the most effective public programs in creating and retaining jobs in the state. Without this tax incentive, Michigan would have lost 10,000 to 34,000 [new] jobs and 15,000 to 40,000 existing jobs.[1]

AN EARLIER STUDY

An earlier unpublished study by the Department of Commerce covering the 1974–1977 period made several noteworthy findings.

1. The most striking aspect of a geographical survey of Public Act 198 is the noticeably high rate of use in southwestern Michigan. Although that area has only 25 percent of the state's manufacturing establishments, almost 62 percent of the exemptions granted were in that region. The area is experiencing relatively rapid economic development, but it is not clear whether the act is contributing to this growth or is being used as a result of the growth. It is likely that the tax incentive is an added bonus for firms considering expansion in the area, rather than a driving force for accelerated development. A survey of industrial developers in the region confirmed the impression that communities in southwestern Michigan have a sound basis for continued expansion (available land, relatively low wage rates, a large and productive labor force, good access to markets, and a high quality of life) and use the state's incentive program effectively. The high rate of use can be attributed largely to the presence of well-trained, well-informed, and professional development organizations in these communities.

2. Although the developers interviewed were generally enthusiastic about the act, neither their comments nor the empirical data give the impression that the act by itself has had a substantial effect on the rate of investment in southwestern Michigan or elsewhere in the state.

TABLE 4

Impact of Incentives on the Decision by Public Act 198 Users to Locate or Expand in Michigan

	This would primarily encourage location there	*This would somewhat encourage location there*	*This would not encourage location there*
If the site is in a certified industrial park	14.3%	45.8%	30.3%
If the community has an active industrial development corporation or is otherwise actively involved in attracting and cooperating with industry	35.5	45.8	8.8
If financing through tax-free industrial revenue bonds is available	47.4	33.5	9.6
If a special property tax exemption for building (or rehabilitating) a plant is available	64.9	25.1	1.6
If site improvements (roads, utilities, and so forth) are offered by the community	52.2	35.9	3.2
If industrial land is available at relatively low cost	55.4	33.5	2.8
If energy utilities have a record of uninterrupted supply to industrial customers	59.4	28.7	3.6

SOURCE: Office of Economic Development, Michigan Department of Commerce.

TABLE 5

What Should State Government Do to Encourage Business Expansion and Location?

	Percentage
1. Reform workers' compensation laws	62.9
2. Reform unemployment insurance laws	52.2
3. Keep Public Act 198—provide tax incentives	10.8
4. Reduce taxes	10.4
5. Reform the Single Business Tax	10.0
6. Reduce government regulation and paperwork	8.8
7. Reduce unionism and union influence in government	4.8
8. Exercise fiscal responsibility—cut government spending	4.4
9. Improve product liability laws	4.0
10. Provide low cost revenue bonding financing	3.2

SOURCE: Office of Economic Development, Michigan Department of Commerce.

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Michigan Economic Indicators

Item	Year previous of latest month	Previous month	Latest month
Manufacturing workers:			
Average weekly hours, Michigan	43.1	41.8	41.4 (July)
Average weekly hours, U.S.	40.3	40.4	40.0 (July)
Average hourly earnings, Michigan ($)	8.21	8.76	8.70 (July)
Average hourly earnings, U.S. ($)	6.17	6.66	6.71 (July)
U.S. motor vehicle production (units)	818,672	796,470	582,982 (Aug.)
Michigan electricity usage (mil. kwh.)	5,741	6,316	5,779 (Apr.)
Industrial (mil. kwh.)	2,766	2,961	2,729 (Apr.)
Residential (mil. kwh.)	1,742	1,943	1,741 (Apr.)
Raw steel production:			
Michigan (000 net tons)	978	981	968 (July)
United States (000 net tons)	11,388	12,230	11,821 (July)
Consumer price index (1967 = 100)			
Detroit area	194.6	215.4	219.5 (July)
United States	196.7	233.1	218.9 (July)
U.S. wholesale price index (1967 = 100)	210.7	233.1	236.6 (July)
Michigan farm prices received index (1967 = 100)	201	229	233 (July)

SOURCES: U.S. Bureau of the Census; U.S. Bureau of Labor Statistics; Michigan Crop Reporting Service; Motor Vehicle Manufacturers Association, Inc.; American Iron and Steel Institute; and Edison Electric Institute.

Contracts for Future Building, First 7 Months: 1978 and 1979

(Thousands of dollars)

Area	Nonresidential			Residential			Total[a]		
	1978	1979	Percentage change	1978	1979	Percentage change	1978	1979	Percentage change
Ann Arbor	38,186	53,056	+ 39	53,398	46,082	− 14	91,584	99,138	+ 8
Battle Creek	11,621	16,332	+ 41	17,429	24,000	+ 38	29,050	40,332	+ 39
Bay City	5,924	5,426	− 8	9,993	8,786	− 12	15,917	14,212	− 11
Detroit	461,964	625,127	+ 35	628,814	691,582	+ 10	1,090,778	1,316,709	+ 21
Flint	44,412	35,020	− 21	59,017	57,098	− 3	103,429	92,118	− 11
Grand Rapids	89,654	129,275	+ 44	119,467	116,492	− 2	209,121	245,767	+ 18
Jackson	8,836	13,553	+ 53	14,203	10,876	− 23	23,039	24,429	+ 6
Kalamazoo-Portage	11,704	23,492	over 100	50,046	41,071	− 18	61,750	64,563	+ 5
Lansing-East Lansing	44,474	52,639	+ 18	71,805	100,969	+ 41	116,279	153,608	+ 32
Muskegon-Norton Shores-Muskegon Heights	16,545	12,156	− 27	19,301	17,344	− 10	35,846	29,500	− 18
Saginaw	52,495	20,800	− 60	31,773	34,101	+ 7	84,263	54,901	− 35
Michigan	903,720	1,127,677	+ 25	1,408,043	1,493,146	+ 6	2,311,763	2,620,832	+ 13
United States	25,290,343	29,258,891	+ 16	43,557,49	45,634,304	+ 5	68,847,792	74,893,195	+ 9

SOURCE: F. W. Dodge Division of McGraw-Hill Information Systems Company, news releases.

NOTE: Battle Creek includes Barry and Calhoun counties; Detroit includes Lapeer, Livingston, Macomb, Oakland, St. Clair, and Wayne counties; Flint includes Genesee and Shiawassee counties; Grand Rapids includes Kent and Ottawa counties; Kalamazoo-Portage includes Kalamazoo and Van Buren counties; Lansing-East Lansing includes Clinton, Eaton, Ingham, and Ionia counties; and Muskegon-Norton Shores-Muskegon Heights includes Muskegon and Oceana counties.

a. Excludes nonbuilding construction contracts. This category comprises streets and highways, bridges, dams, reservoirs, river and harbor developments, sewerage and water supply systems, missile and space flight facilities, airports, utilities, and communication systems. For Michigan the 1978 and 1979 figures for nonbuilding construction contracts were $1,080,687,000 and $636,442,000, respectively, or a decrease of 41 percent. U. S. figures for nonbuilding construction contracts were $23,847,270,000 and $26,447,719,000, or an increase of 11 percent. Total building and nonbuilding construction contracts declined 4 percent in Michigan and 9 percent nationally.

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A definitive conclusion cannot be reached that the act is not accomplishing its intended purpose, but the survey certainly cannot be viewed as testimony to its effectiveness.

3. No data are available on the number of applications disapproved at the local level, but it appears to be quite low. In the six western communities surveyed, not one request had been denied. In addition, only one of the exemptions provided relief for less than the maximum of 12 years. The inference is that most local governments are disposed toward granting abatement. Since the number of applications is increasing geometrically over time, one would expect continued tax exemptions in the interest of immediate expansion. The surrender of tax base has reached a very high proportion in some communities. The effects are not entirely evident at present, but seem potentially troublesome (see Table 6). Some local governments, such as Wayne County, and many school districts have begun to complain about the loss of revenue, and some have proposed that the state bear the costs of the exemptions.

4. The principal beneficiaries of exemptions granted under the act are the automakers — 61.5 percent of the amount exempted went to the Big Three (see Table 7). A case can be made that a refusal to extend abatement to the Big Three would result in erosion of the state's economic base; but given the extent of the auto industry's existing investment in Michigan, there appears little chance of massive relocation. Table 8 indicates very nearly the same proportion of employment among the automakers for 1971–1973, before the act was passed, as for the next four years. Despite the importance of the auto industry to Michigan, one can question the wisdom of expending such benefits on these companies, particularly in light of the state's need to diversify its industrial base.

5. Even assuming the local fiscal effects of the act are not deleterious, it must be kept in mind that tax abatement is not costless. The combined effects of rising municipal costs and restrictions on the property tax base (particularly since the passage of the Headlee tax limitation) may require shifting part of the tax burden from users of Public Act 198 to residential property owners and nonexempt businesses. For example, in Detroit the share of property taxes paid by homeowners increased from 45.5

TABLE 6
Communities in Which Exempt State Equalized Valuation Is 15 Percent of Total State Equalized Valuation: 1977

	Exempt from State Equalized Valuation	*Percentage of State Equalized Valuation of unit*[a]
Constantine (Village)	$ 49,368,250	80.5
Three Rivers	86,631,050	68.0
Milan	63,662,732	64.5
Charlevoix Township	24,500,000	55.1
Ypsilanti Township	252,436,968	45.1
Romulus	102,311,454	33.3
Everett Township	2,130,964	28.7
Bagley Township	15,875,000	27.9
Buena Vista Township	48,257,000	26.3
L'Anse (Village)	3,170,111	24.3
Albion	12,319,211	21.7
Manistique	4,124,256	21.3
Sparta (Village)	4,906,478	21.2
Allen Township	8,891,540	20.6
Filer Township	4,615,309	17.6
Vassar	3,162,309	17.4
Harbor Beach	4,653,534	17.2
Alma	8,891,540	16.9
Zeeland	7,370,706	16.5
Wyoming	72,854,871	16.3
Eau Claire (Village)	679,292	15.7

SOURCE: Office of Economic Development, Michigan Department of Commerce.
[a]Percentage of State Equalized Valuation of unit is calculated by dividing the equalized value of exempt facilities by the sum of total State Equalized Valuation and the State Equalized Valuation of these facilities. This figure is substantially lower than the ratio of exempt State Equalized Valuations to all other State Equalized Valuations. In Constantine, for example, the latter ratio would be $49,368,250 divided by $11,994,039 = 412 percent.

TABLE 8
Percentage of Total Corporation Employment in Michigan by the Big Three: 1971–1977

	Chrysler	*Ford*[a]	*General Motors*
1971	57.6	53.4	44.4
1972	58.7	53.7	44.6
1973	58.5	55.1	43.9
1974	57.5	54.9	44.3
1975	58.4	55.7	44.4
1976	60.6	54.9	44.6
1977	60.5	53.8	44.9

SOURCE: *Michigan Statistical Abstract* for 1978, p. 857.
[a]Excludes Ford Aerospace and Communications Corporation and finance and insurance subsidiaries.

TABLE 7
Summary of Exemptions Granted to the Automakers: 1974–1977

	Number of projects (new/rehab.)	*Dollar amount exempted*	*Percentage of all dollars exempted*	*Jobs created*	*Percentage*	*Jobs created*	*Percentage*
Ford	4 (4/0)	350,100,000	16.26	0	—	4,065	10.25
GMC	18 (16/2)	849,696,409	39.47	12,100	25.55	14,041	35.36
Chrysler	3 (1/2)	124,935,602	5.80	8,170	17.25	434	1.09
Total	25	1,324,732,011	61.54	10,270	42.79	18,540	46.69

SOURCE: Office of Economic Development, Michigan Department of Commerce.

percent in 1973 to 50.9 percent in 1978. The most evident fiscal effect of the act, however, is the increase in school aid payments as a result of the removal of exempt industrial facilities from the assessment rolls.

6. Finally, employment effects are not evident. Certainly, new facilities will create jobs, but since it cannot be known with any degree of certainty whether investment covered by this act would have occurred in its absence, it is not known how many jobs can be attributed directly to the act. Renovation of plants results in retention of jobs, although not necessarily at the prerehabilitation level.

STATE AND LOCAL FISCAL EFFECTS

In 1978, in accordance with a requirement of a 1977 public act,[2] the Michigan Department of Commerce prepared a report on the impact of Public Act 198 on three Michigan communities. More than $96 million in property (state equalized valuation) is, or will be, effectively exempted from all property taxes as construction is completed. Ypsilanti Township has 45 percent of its tax base exempted under the act; Menominee, 14 percent; and Grand Rapids, 2 percent. Upon completion of the projects, more than $5 million in tax revenues will be forgone by all the taxing districts involved. This amounts to $600 of forgone tax revenue annually for each job created.

None of the local officials expressed concern about lost revenue as a result of the act. They believed that since new industrial expansions received tax exemptions, nothing was taken away from the current tax base, and potential tax revenue was treated as forgone for 12 years in order to realize economic growth now.

In the communities studied, the cost to the city or township of providing services to industry amounts to no more than 15 percent of the property taxes paid. Industrial property, especially in areas such as Menominee and Ypsilanti Township, where it is expanding, effectively subsidizes services provided to residents. Under Public Act 198, a new facility reduces this subsidy but still contributes 70 percent of its tax levy to the community for other services. The effective subsidy, therefore, holds down millage rates and makes it profitable for the community to solicit industrial development, even at one-half the normal tax rate.

Induced population growth attracted by new jobs in industry will tend to negate the subsidy's effect. This is because residents are relatively more expensive to service than is industry, which often supplies its own security force and handles its own waste disposal and fire control.

The study also concluded that industrial and commercial properties enhance the fiscal strength and stability of the local communities due to the tax subsidy they contribute after deducting service costs. The amount of this subsidy in the three communities amounts to about $2.4 million, even with Public Act 198 exemptions. In Grand Rapids, the 1,500 new jobs created by the act will produce about $130,000 in income tax revenue, which more than offsets the forgone property tax revenue. In Ypsilanti Township and Menominee, forgone tax revenues amount to less than 3 percent of the budget.

Most school districts that levy up to 30 mills do not lose any revenue as a result of exemptions under the act because they are compensated by the state school aid formula, which equalizes operating revenues per pupil up to the first 30 mills of tax levy. School districts that do not qualify for direct state aid do receive the industrial facilities taxes (IFT) collected from exempt industries by the school tax levy. Districts that levy more than 30 mills receive directly the IFT collected by that portion of their levy above 30 mills. In Grand Rapids, school districts forgo about $37,000 in potential tax revenue annually. In Ypsilanti Township, school districts forgo about $730,000 annually due to Public Act 198 exemptions. In at least one case, however, declining school enrollment was seen as a more serious problem because of the subsequent loss of state aid. Industrial growth was viewed as one way to attract residents and ensure a rising enrollment.

To summarize, the study reached several conclusions.

1. Public Act 198 has encouraged industry to expand and locate in Michigan. Without it, states such as Ohio would have a significant tax advantage over Michigan.

2. In areas in which the act has been used, local job growth has exceeded the state average. (However, the study did not attempt to determine job growth prior to passage of the act.)

3. Granting tax exemptions to industry under the act will not impair the fiscal strength or stability of the community. Industrial expansion is needed to hold down tax rates and reduce the tax burden on residents.

4. In cities with income tax, forgone property tax revenues are offset by income tax revenue generated by new jobs.

5. Most school districts are largely compensated by state aid for potential revenue lost through industrial exemptions.

Public Act 198 exemptions impose a significant cost on the state, as school aid payments are increased as a result of the decline in state equalized valuation in school districts in which tax abatements are granted. As Table 9 indicates, this cost has increased rapidly since 1974.

CONCLUSION

It is not possible to state categorically that Michigan's tax incentive program has been a major success or a failure. There is no question that Public Act 198 has had a positive psychological effect on businesses considering location or expansion in the state. Prior to its enactment, Michigan had few inducements to offer business. Most efforts were of a defensive nature, explaining to business that taxes were not very high, that the high rate of unionization did

TABLE 9
Cost to the State of Michigan of Public Act 198 Exemptions

Year	*Amount*
1974	$ 713,473
1975	3,830,947
1976	8,805,223
1977	20,265,287
1978	39,760,736

SOURCE: State Tax Commission, Michigan Department of the Treasury.

not hurt worker productivity, that government officials were not antibusiness, and that the weather was not that bad. Today, there are positive programs that can be used to sell Michigan as an industrial location.

There is no question that the act has helped attract and retain many businesses. The unanswered questions are: Has the program been worth the cost? And, could the forgone revenues have been used more effectively to create and retain jobs? For example, it is possible that tax credits (against the Single Business Tax) tied to workers' compensation and unemployment insurance costs, tax credits for new employees, subsidized loans, or a general tax reduction would be more effective in improving the Michigan business climate than is Public Act 198. However, alternatives to the act have never been examined. This is unfortunate. As its use has increased, there have been unsettling developments. First, an increasingly large share of total Michigan investment is receiving exemptions under the program, and the cost in forgone government revenue is escalating. As a result, many local officials are becoming concerned about the program and, as mentioned above, are suggesting that the state bear the full cost. There has been great reluctance on the part of local officials to deny exemptions, due in part to a fear they will lose business to another jurisdiction. Some businesses are not above resorting to corporate blackmail to achieve favorable tax treatment. State and local governments often are unable to resist such pressures; they grant tax breaks that they sometimes regret. As one observer has noted:

> The ability of industry to move easily from one place to another in search of higher profits is one of the worst problems facing states and cities today. Officials are often paralyzed by the knowledge of corporate mobility. They shy away from innovative tax or regulatory policies for fear that existing companies will leave or that others will boycott them. In fact, any attempt to stop or put a price on those businesses which abandon a plant and community has been attacked as bad public policy under the rationalization that such moves were motivated by the need for industrial efficiency and thus were good for the country as a whole.[3]

Legislation recently has been introduced in Michigan that would require businesses leaving a community to repay any tax or financial incentives received as an inducement for locating there. This legislation is unlikely to pass in the near future, but indicates a growing concern.

As use of the act expands in relation to total investment in Michigan, it will be more difficult for its advocates to claim the program is cost effective; the cost of the exemptions granted to businesses that would have expanded in Michigan anyway will begin to outweigh the economic gains from firms that were encouraged by the tax incentive to expand in the state. The result could be a reevaluation of the program in the near future.

Another development is the recent expansion of the exemption to cover commercial businesses (Public Act 255 of 1978). This was to be expected once nonindustrial businesses recognized the tax benefits being enjoyed by their industrial brethren. The new act was intended to encourage revitalization of downtown commercial districts, but efforts to limit it to those areas were not successful. There are restrictions, but they still will allow the use of the act in the suburbs, small towns, and rural areas. There are three reasons the use of this incentive should have been restricted carefully. First, its objective is to revitalize commercial districts in declining urban areas. Accordingly, commercial development in newly developed areas should not be encouraged. If fast-growing suburbs can grant the incentive, the bill actually will work against declining downtown areas. Second, the location of commercial establishments is more market oriented than the location of industrial concerns, which argues for restricting tax incentives in order to prevent marginally profitable facilities from being built. Third, the granting of tax abatement to selected firms constitutes tampering with market forces, which could result in an inefficient allocation and increased competition among existing firms.

Granting tax incentives to commercial facilities could be more costly than the industrial facilities exemption. Also, it is much less likely to encourage new investment and jobs, as the location decisions of commercial firms are much more dependent on market factors than are those of industrial firms.

Michigan's experience with tax incentives has indicated that incentives can be a useful tool for industrial development, but that they should be used carefully. Tax incentives, if they must be used, should be targeted to attract firms that will add to the economic stability and diversity of the state's economy. The granting of tax exemptions should not be automatic. A careful evaluation should be made of the likely effect of the incentive on the firm's location decision. The entire burden of granting an exemption should not be placed on local units. They should play the major role in the decision process, but the state also should be involved. School districts are largely reimbursed for costs associated with exemptions; however, other local units of government must bear full costs. A strong case can be made for changing the latter situation. Finally, incentives should be granted to commercial businesses only under restrictive conditions.

If carried too far, tax competition can weaken the financial position of state and local governments, making them even more dependent on the federal government. It can only be hoped that government officials will be more prudent in their use of tax and financial business incentives in the future.

CITATIONS

1. Office of Economic Development, Michigan Department of Commerce, "A Report on Companies Using the Plant Rehabilitation and Industrial Development Districts Law" (Lansing: 1979).
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